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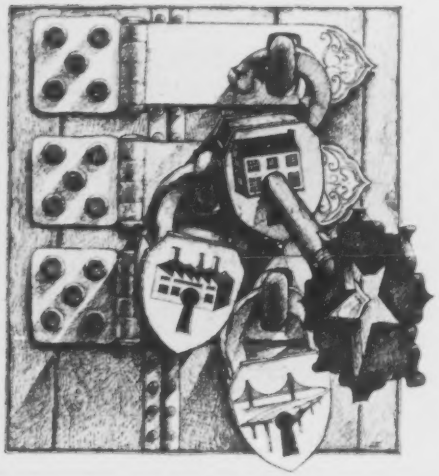
1983 Dodge/Sweet's Construction Outlook

First Update
March 1983



The message of last October's *1983 Construction Outlook* was one of recovery. In this *First Update*, recovery is not only taking hold—it is gaining new sources of strength.

With interest rates falling sharply through the second half of 1982, construction contracting advanced even faster than expected. As measured by the Dodge Index of construction activity, the value of newly started work rose 22 percent between last year's second and fourth quarters. In dollar terms this means that the annualized rate of contracting for construction of all kinds was $30 billion stronger in the final quarter than in the second.

That change *alone* virtually guarantees stronger demand for building products and higher employment in the construction trades during 1983's first half, as the additional work started last fall is brought to completion in the months ahead. But the 1983 outlook is even better than that. Developments since last fall now support a forecast of still higher contracting for new construction in 1983. In particular:

- Housing starts, which were originally estimated at 1.325 million units, can now be expected to reach 1.475 million in 1983—mostly because mortgage rates have fallen faster than assumed.
- Public works construction, which had been heading for another decline in 1983, is now positioned for a gain instead, due to the new fuel tax and the acceleration of previously planned public projects.

Compared with the original scenario—1983 would bring a good gain in housing, but little more than that—the construction market's recovery is broadening to embrace public works as well. The turnaround of commercial and industrial building, however, requires the support of vigorous general economic expansion, and it will take most or all of this year to create that environment.

Monetary and Budgetary Priorities

In 1983 the biggest single threat to the continuation of the half-year-old recovery of construction contracting is the possibility that interest rates may rise again. It happened not long ago under similar circumstances.

There are hardly any good reasons for a re-tightening of credit in 1983, but there is one compelling reason for continued ease: support of the economy's sputtering recovery with still lower interest rates.

Short-run economic strategy clearly calls for maximum stimulus, and it is on the way:

- The chairman of the Federal Reserve has indicated that as long as inflation remains dormant, monetary policy will continue to support the economy's recovery—the course the Fed set last summer. Considering the extent of idle capacity throughout the economy, the risk of renewed inflation in 1983 is negligible.
- Appeals to cancel the mid-1983 income tax cut have been politely dismissed. There will be time enough in 1984 (or more likely 1985) to determine what kind of tax increases and spending cuts are needed to deal with the remaining hardcore deficit.

For these reasons, national economic policy—and most importantly, monetary policy—can be assumed to behave in a supportive way as the economy struggles out of deep recession during 1983 and 1984. As long as this assumption holds, the rest of the construction outlook will follow a familiar and predictable pattern.

Residential Building

Everything clicked for housing in January: mortgage rates declined, the weather was generally mild, builders and buyers were optimistic. As a result, the housing market got off to a roaring

start in 1983's opening month when the seasonally adjusted rate of starts leaped to 1.7 million units from December's 1.3 million.

Conditions in the housing market are improving, but they aren't that good—yet. The extraordinary January rate must be interpreted as a statistical aberration, the consequence of everything going right in a month when seasonal adjustment factors allow for a lot of things to go wrong. Since $80,000 price tags and 13 percent mortgages are not quite consistent with a sustained volume of building at a rate of 1.7 million units, it is to be expected that once the building season begins in earnest, housing starts will settle down within the more credible range of 1.4 to 1.5 million units.

The rate of housing starts will ease back from an unrealistically high first-quarter volume, and later rebound to a rate of 1.55 million by the fourth quarter. The year's total is likely to be something above 1.45 million units—tentatively 1.475 million—with an outside chance of breaking 1.5 million units. The highest probability estimate for 1983 is a mix of 900,000 one-family homes and 575,000 multifamily units.

If the economy's recovery picks up momentum in 1983's second half, it is not hard to imagine that the Federal Reserve will begin backing away from monetary stimulus before year-end. When it does, mortgage rates are expected to firm in the range of 12.0 to 12.5 percent. Assuming that rates are not pushed up again by excessive monetary restraint, or bid up by stronger loan demand in 1984, housing starts next year are tentatively forecast to increase further to 1.65 million starts under conditions of stable rates. As multifamily building approaches a ceiling of 600,000 units, one-family housing is projected to exceed one million units in 1984.

1983 National Estimates
Dodge Construction Potentials

First Update March 1983

		1982 Actual	1983 Forecast	Percent Change 1983/82
Nonresidential Buildings				
Floor Area (millions of square feet)	Office Buildings	260	185	-29
	Stores & Other Commercial	309	340	+10
	Manufacturing Buildings	116	110	- 5
	Total Commercial & Manufacturing	685	635	- 7
	Educational	75	75	—
	Hospital & Health	71	69	- 3
	Other Nonresidential Buildings	111	118	+ 5
	Total Institutional & Other	257	262	+ 1
	Total Nonresidential Buildings	942	897	- 5
Contract Value (millions of dollars)	Office Buildings	$ 17,225	$ 12,775	-26
	Stores & Other Commercial	10,774	12,300	+14
	Manufacturing Buildings	9,251	6,400	-31
	Total Commercial & Manufacturing	$ 37,250	$ 31,475	-16
	Educational	$ 6,124	$ 6,475	+ 6
	Hospital & Health	7,858	8,050	+ 2
	Other Nonresidential Buildings	7,975	8,500	+ 7
	Total Institutional & Other	$ 21,957	$ 23,025	+ 5
	Total Nonresidential Buildings	$ 59,207	$ 54,500	- 8
Residential Buildings				
Dwelling Units** (thousands of units)	One-Family Houses	633	900	+42
	Multifamily Housing	422	575	+36
	Total Housekeeping Residential	1,055	1,475	+40
Floor Area (millions of square feet)	One-Family Houses	993	1,410	+42
	Multifamily Housing	411	575	+40
	Nonhousekeeping Residential	60	57	- 5
	Total Residential Buildings	1,464	2,042	+39
Contract Value (millions of dollars)	One-Family Houses	$ 37,535	$ 57,250	+53
	Multifamily Housing	16,261	24,200	+49
	Nonhousekeeping Residential	4,280	4,400	+ 3
	Total Residential Buildings	$ 58,076	$ 85,850	+48
Nonbuilding Construction				
Contract Value (millions of dollars)	Highways & Bridges	$ 12,275	$ 14,500	+18
	Sewer & Water	7,357	7,000	- 5
	Other Public Works	6,276	6,400	+ 2
	Total Public Works	$ 25,908	$ 27,900	+ 8
	Utilities	$ 11,428	$ 10,000	-12
	Total Nonbuilding Construction	$ 37,336	$ 37,900	+ 2
All Construction				
Contract Value (millions of dollars)	Total Construction	$154,619	$178,250	+15
	Dodge Index (1977 = 100)	111	128	

**F.W. Dodge basis

Nonbuilding Construction

Beginning soon, two new programs will pump up public works construction in the mid-1980's in much the same way that the Local Public Works Act did in the 1970's. And the object is the same as before: create jobs.

One of these two new programs, the Surface Transportation Assistance Act of 1982, is near enough to implementation so that its 1983 impact can be roughly estimated. Each year from 1983 through 1986 it will add an extra layer of Federal funding of about $5.5 billion to the nation's pre-existing $9-billion-a-year basic transportation construction program. The new increment will provide its own funding via a 5¢-a-gallon fuel tax, the proceeds of which will be split 80 percent for highway and bridge construction and 20 percent for mass transit equipment purchases.

Because the new program doesn't take effect until April 1st, its 1983 addition to highway/bridge construction funding will be less than the eventual $4.4 billion annually. Moreover, there is bound to be some substitution of these new Federal funds for projects that otherwise would have been built with increasingly scarce state and local taxes. On balance, STAA-82 is likely to add a *net* $2 to $2.5 billion to highway and bridge construction in 1983, and more in 1984, 1985 and 1986.

The other new program hadn't taken final form as this was written but it was close enough to passage to anticipate its major provisions. Under pressure

1983 Regional Estimates
Dodge Construction Potentials

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Northeast

Connecticut, District of Columbia, Delaware, Massachusetts, Maryland, Maine, New Hampshire, New Jersey, New York, Eastern Pennsylvania, Rhode Island, Virginia, Vermont

Contract Value (millions of dollars)

	1982 Actual	1983 Forecast	Percent Change 83/82
Nonresidential Buildings			
Commercial and Manufacturing	$ 6,438	$ 5,875	− 9
Institutional and Other	4,584	4,675	+ 2
Total	$11,022	$10,550	− 4
Residential Buildings			
One-Family Houses	$ 5,687	$ 8,825	+55
Multifamily Housing	3,066	4,650	+52
Nonhousekeeping Residential	1,052	925	−12
Total	$ 9,805	$14,400	+47
Nonbuilding Construction			
Highways and Bridges	$ 2,471	$ 2,825	+14
Other Public Works	2,884	2,800	− 3
Utilities	1,171	1,000	−15
Total	$ 6,526	$ 6,625	+ 2
Total Construction	$27,353	$31,575	+15

South

Alabama, Arkansas, Florida, Georgia, Southern Illinois, Kansas, Louisiana, Mississippi, Missouri, North Carolina, Nebraska, Oklahoma, South Carolina, Tennessee, Texas

Contract Value (millions of dollars)

	1982 Actual	1983 Forecast	Percent Change 83/82
Nonresidential Buildings			
Commercial and Manufacturing	$14,103	$12,200	−13
Institutional and Other	7,590	8,300	+ 9
Total	$21,693	$20,500	− 5
Residential Buildings			
One-Family Houses	$17,790	$26,775	+51
Multifamily Housing	7,086	10,150	+43
Nonhousekeeping Residential	1,604	1,600	—
Total	$26,480	$38,525	+45
Nonbuilding Construction			
Highways and Bridges	$ 4,250	$ 5,225	+23
Other Public Works	4,650	4,700	+ 1
Utilities	3,198	3,900	+22
Total	$12,098	$13,825	+14
Total Construction	$60,271	$72,850	+21

Midwest

Northern Illinois, Indiana, Iowa, Kentucky, Michigan, Minnesota, North Dakota, Ohio, Western Pennsylvania, South Dakota, Wisconsin, West Virginia

Contract Value (millions of dollars)

	1982 Actual	1983 Forecast	Percent Change 83/82
Nonresidential Buildings			
Commercial and Manufacturing	$ 7,419	$ 5,225	−30
Institutional & Other	4,803	4,675	− 3
Total	$12,222	$ 9,900	−19
Residential Buildings			
One-Family Houses	$ 5,374	$ 7,925	+47
Multifamily Housing	2,394	3,550	+48
Nonhousekeeping Residential	402	425	+ 6
Total	$ 8,170	$11,900	+46
Nonbuilding Construction			
Highways and Bridges	$ 3,022	$ 3,475	+15
Other Public Works	2,681	2,450	− 9
Utilities	2,718	1,500	−45
Total	$ 8,421	$ 7,425	−12
Total Construction	$28,813	$29,225	+ 1

West

Alaska, Arizona, California, Colorado, Hawaii, Idaho, Montana, Nevada, New Mexico, Oregon, Utah, Washington, Wyoming

Contract Value (millions of dollars)

	1982 Actual	1983 Forecast	Percent Change 83/82
Nonresidential Buildings			
Commercial and Manufacturing	$ 9,290	$ 8,175	−12
Institutional & Other	4,980	5,375	+ 8
Total	$14,270	$13,550	− 5
Residential Buildings			
One-Family Houses	$ 8,684	$13,725	+58
Multifamily Housing	3,715	5,850	+57
Nonhousekeeping Residential	1,222	1,450	+19
Total	$13,621	$21,025	+54
Nonbuilding Construction			
Highways and Bridges	$ 2,532	$ 2,975	+17
Other Public Works	3,418	3,450	+ 1
Utilities	4,341	3,600	−17
Total	$10,291	$10,025	− 3
Total Construction	$38,182	$44,600	+17

from Congress to come up with more of a jobs program than the user-tax-supported highway bill (which many argue will have only a neutral impact on net employment), the Administration is offering a $4.3-billion package of job-stimulating expenditures and "humanitarian" aid. Other proposals would add an extra billion or more to this base. In the bill's present status, roughly three-quarters of the $4.3 billion is construction related, with funds for highways, airports, water resources, Federal office buildings, prisons and military housing, as well as for community development block grants and urban development action grants.

It is unclear how much of the money, which is to be provided through a supplemental appropriation in fiscal year 1983, is "new" and how much will be "borrowed" from future budgets. What is clear is that after several years of budgetary restraint, public works construction will be getting a temporary lift in 1983 (and 1984) that will be at least the equivalent of the Local Public Works Act of the late 1970's.

Nonresidential Building

Contracting for commercial and industrial building typically lags general business activity by as much as a year. With the economy only now beginning to recover, it will take most of 1983 to set the stage for the next expansion of non-

residential building. Before adding new buildings, it is first necessary to take up the considerable slack in underutilized existing structures.

It is hard to say whether there is more excess capacity in factories or in offices at the moment. The slack in both areas is considerable, though for different reasons.

Industrial Unused manufacturing capacity has been accumulating steadily since 1979, severely limiting the need for new industrial building. In 1982, at the recession's low point, contracting for factory space fell to 116 million square feet—the lowest volume in over twenty years—and even that turned out to be more than industry required.

Through 1983, rising industrial output will begin to absorb idle capacity, but the utilization rate, now at 68 percent, isn't likely to be higher than 72 percent by year-end. Whenever capacity utilization is below 75 percent, as it was in 1982 and will be in 1983, the demand for industrial construction is limited to rock-bottom essentials: relocation, replacement, and the expansion needs of those few industries which somehow manage to avoid recession. The turnaround of the industrial *production* this year will be the first necessary step toward the recovery of industrial *construction* in 1984, but it won't generate any more than minimum demand for buildings in 1983.

Offices Although the problem of surplus industrial space is due to weak demand, the current surplus of office space is more a matter of too much supply. Either way, the marketplace requires a downward adjustment of construction.

Office building peaked in 1981 when a record volume of 325 million square feet was offered to a market that was capable of digesting about 200 million square feet on a continuing basis. Even though some of that surge of building was intended to satisfy a backlog of need carried over from prior years, when the growth of the white collar labor force outpaced new construction, an adjustment was inevitable.

A 20 percent decline in contracting in 1982 (to 260 million square feet) wasn't enough to restore balance. At that rate of contracting more new space was still being added than could be used, and vacancy rates rose sharply. Balance between demand and supply in the office building market can only be established by further reduction of building in 1983—perhaps by as much as another 25 to 30 percent.

Despite the need for further correction, opportunities exist in the highly localized office building market. Much of the present surplus is concentrated in several Southwestern metropolitan areas, leaving many other cities with potential for development.

Retail Store and warehouse contracting is nonresidential building's best bet for improvement in 1983. A 10 percent advance in last year's final quarter, and a further gain in January, may be early signs that retail building is once again doing what it usually does: it follows housing.

Since the late 1970's, when housing starts toppled from their 2-million- unit level, the retreat of contracting for stores/warehouses paralleled homebuilding closely. By 1982, both housing and retail building had declined by 50 percent.

Soon housing will be leading the recovery of stores/warehouses through 1983 and 1984. If the housing forecast of 1.475 million starts for 1983 is on target, allowance for a brief lag means that the demand for stores/warehouses will be close to 280 million square feet this year, a gain of almost 15 percent.

A Progressive Recovery

The near-term outlook for construction markets is one of recovery by stages. Housing started things off in the second half of 1982. That beginning is due to be reinforced by a rise in public works construction during 1983. By 1984 the gain in housing and public works will be joined by the recovery of commercial and industrial building.

The fulfillment of this progression to full recovery depends heavily on what happens to interest rates toward the end of 1983. For the time being, there is not much risk that interest rates will rise sharply and stall the construction market's long-awaited recovery.

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The Outlook

Nonresidential Building Contract Value

Seasonally adjusted annual rates, in billions of dollars

Year/Quarter		Total	Commercial/ Industrial	Institutional
1982	I	$65.7	$45.5	$20.2
	II	56.5	35.9	20.6
	III	58.7	35.6	23.1
	IV	55.9	31.8	24.1
1983	I	$55.8	$33.5	$22.3
	II	53.8	31.0	22.8
	III	53.3	30.1	23.2
	IV	55.1	31.4	23.7
1982		$59.2	$37.2	$22.0
1983		$54.5	$31.5	$23.0
% Change		− 8	−16	+ 5

Residential Building Contract Value

Seasonally adjusted annual rates, in billions of dollars

Year/Quarter		Total	One Family	Multi-Family*
1982	I	$51.6	$34.9	$16.7
	II	54.4	34.4	20.0
	III	58.2	36.0	22.2
	IV	68.2	44.7	23.5
1983	I	$78.1	$51.3	$26.8
	II	83.5	55.3	28.2
	III	88.3	59.2	29.1
	IV	93.7	63.4	30.3
1982		$58.1	$37.5	$20.6
1983		$85.9	$57.3	$28.6
% Change		+48	+53	+39

*Includes Nonhousekeeping Residential Buildings

Nonbuilding Construction Contract Value

Seasonally adjusted annual rates, in billions of dollars

Year/Quarter		Total	Public Works	Utilities
1982	I	$41.9	$28.7	$13.2
	II	31.9	25.8	6.1
	III	34.5	24.3	10.2
	IV	40.9	24.8	16.1
1983	I	$33.5	$25.5	$ 8.0
	II	35.6	27.6	8.0
	III	38.7	28.7	10.0
	IV	43.8	29.8	14.0
1982		$37.3	$25.9	$11.4
1983		$37.9	$27.9	$10.0
% Change		+ 2	+ 8	−12